No. 5689.

IN THE

United States
Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Alameda Investment Company, a corporation;

Hawley Investment Company, a corporation;

Pacific Nash Motor Company, a corporation,

Appellants.

vs.

John P. McLaughlin, Collector of Internal Revenue for the First District of California,

Appellee.

PETITION FOR REHEARING.

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PETITION FOR REHEARING.

To the Honorable Presiding Justice and Associate Justices of the U. S. Circuit Court of Appeals for the Ninth Circuit:

Appellants, Alameda Investment Company, Hawley Investment Company and Pacific Nash Motor Company, respectfully petition for an order granting a rehearing in the above entitled case.

With all due deference and respect we beg to call Your Honors' attention to what we believe to be errors of fact in the decision of this court which should, we submit, be

sufficient to induce this court to grant a rehearing. In addition we feel that the court has overlooked the express terms of the statute and the settled principles of law applicable to the true facts of the case, which, we submit, is a proper basis for a rehearing.

I.

We Respectfully Submit That the Court Erred in Finding That the Respondent Denied in His Answer the Allegation of the Complaint That Separate Returns Were Filed "Without Knowledge of the Right to File Consolidated Returns."

The complaint in paragraph 10, Record, page 5, alleged as follows:

> "Said plaintiff corporations through inadvertence, *and without knowledge* that they were entitled to file a consolidated return of income * * * filed with the Defendant separate returns of income for the calendar year 1922."

The Respondent in answering paragraph 10 of the complaint [Record p. 15] plead as follows:

> "Defendant denies that any tax returns whatsoever were filed by plaintiff corporations through *inadvertence*, and particularly alleges that for the calendar year 1922 the individual and several returns of plaintiff corporations were not filed through *inadvertence*, but same were properly filed according to provisions of the Revenue Act of 1921."

The decision of this court reads as follows:

> "We have not lost sight of the fact that the complainant alleged that the separate returns were made through inadvertence and without knowledge that the taxpayers were entitled to make a consolidated return, but the allegation was denied by answer and no proof whatever was offered in its support."

We respectfully point out that the answer did not deny the "without knowledge" allegation of the complaint. The denial of inadvertence is not a denial of lack of knowledge. Inasmuch as the answer did not deny that the separate returns were filed without knowledge, the complainants did not need to introduce testimony or to offer proof that the separate returns were made without knowledge of the right to file a consolidated return. This error of fact is exceedingly important. No binding election can be imposed upon appellants without knowledge of the two inconsistent remedies. This principle is more fully set forth in our original brief on pages 28 and 29.

II.

We Also Respectfully Submit That the Court Erred in Finding That the Commissioner of Internal Revenue Denied the Appellant, Alameda, Permission to File a Consolidated Return.

The three appellant corporations originally filed separate returns. Later they filed a conslidated return. The Commissioner approved the consolidated return, except that he ruled that the Alameda Investment Company was not affiliated with the two other appellant companies.

This Honorable Court said that the Commissioner excluded the Alameda from the consolidated group because he had denied the Alameda permission to change from a separate to a consolidated return basis.

We believe this is erroneous. We have previously shown that the Alameda was a part of the affiliated group in 1922.

Therefore, this matter is governed by section 240 (a) of the Revenue Act of 1921. That section provides:

> "That corporations which *are affiliated* * * * may * * * make *separate* returns or * * * make *a* consolidated return."

What does this language mean? The Commissioner has construed the language in Solicitor's Memorandum #2682, Cumulative Bulletin IV–1, 238, as follows:

> "The language of section 240 (a) is specific. It states that, 'Corporations which *are affiliated* * * * may make *separate* returns *or* * * * make *a* consolidated return.' This language can mean but one thing, that the group as a *whole* may render individual corporate returns, or that the *group* as a *whole* may render *a* consolidated return * * * they *must* for any taxable year * * * file *one* consolidated return for the *entire group, or* file individual returns for *each* corporation."

This section and the interpretation of the section, clearly shows that an affiliated group cannot be split. Part of the corporations in the group cannot file a consolidated return, while other corporations of the group file separate returns. Since this is the specific terms of the statute then it applies to both taxpayers and the Government.

It is contended by the Respondent that the companies could not file an amended consolidated return without securing the permission of the Commissioner to change their basis from separate to consolidated returns. Naturally when the Commissioner is asked for permission to change the basis from separate to consolidated returns he will want to examine the stockholdings and stock control of the corporations to see whether or not they *are affiliated*.

In this case the Commissioner examined the amended consolidated returns filed for these companies for the years 1920, 1921 and 1922. He freely gave the companies permission to change their basis from the filing of separate to the filing of consolidated returns for those three years. [Respondent's Exhibit No. 4, Record p. 57.]

The Commissioner's "ruling letter" shows that the Commissioner allowed the Alameda Investment Company to be affiliated with the other appellants until December 1st, 1920, when twenty-five per cent of its stock was acquired by the H. W. Meek Estate, Inc. The Commissioner denied the Alameda affiliation with the other companies after that date, and ordered it to file separate returns after December 1st, 1920. What reason did the Commissioner give for excluding the Alameda from the affiliated group?

The reason is given in the ruling letter [Record p. 58]. It said:

> "The Alameda Investment Company *was not affiliated* during these years, *and* should have filed a separate return for each of these years."

The Commissioner did not say that he was denying affiliation to the Alameda because he was denying it the privilege to change its basis from the filing of a separate return to the filing of a consolidated return, or for any other reason except that in his opinion substantially all of its stock was not owned or controlled by the same interests which owned or controlled substantially all of the stock of the other two appellant companies. The reasons *given* by the *Commissioner* for denying the Alameda inclusion in the affiliated group *should govern.*

The lower court and this Honorable Court said that the Commissioner excluded the Alameda from the affiliated group because the Commissioner denied the Alameda permission to change its basis from the filing of separate to the filing of a consolidated return. This ruling seems to overlook the express provisions of the statute which clearly says that some of the corporations of an affiliated group cannot file a consolidated return while other corporations of the affiliated group file separate returns.

This Honorable Court can only say that the Commissioner *denied* the Alameda *permission to change its basis* of filing returns by *presuming* that the *Commissioner violated the statute.*

It is a well known presumption that public officers are presumed to have acted in accordance with the provision of law. There is no presumption that a public officer has acted unlawfully.

To rule against the appellants in this case on the *theory* that the *Commissioner denied* the Alameda the *permission* to *change* its *basis* of filing returns, is to *deny* to the *appellants* a *judicial review* of the *question* of *affiliation.* There is no unreviewable discretion in the Commissioner in regard to affiliation. The conditions warranting affiliation are specifically contained in the statute.

There is *no question* of *election in this case.* The only question is affiliation (and protest). The Commissioner readily gave appellant companies permission to file consolidated returns *provided* they could *prove* that they were *affiliated.* The Commissioner does not believe that the Alameda is affiliated with the other two companies, but

the Commissioner *never contended* that he had *denied* the *Alameda permission* to *change* its *basis.*

Your Honors will recall that the Respondent in his reply brief did not mention the question of election brought out by the lower court, nor did he mention this question at the hearing even after counsel for appellants had called Your Honors' attention to the fact that the Respondent did not mention the question of election in his reply brief. Counsel for appellants mentioned at the oral argument that the Respondent had apparently conceded that the Alameda had been given permission to change its basis from the filing of a separate to the filing of a consolidated return. Even then counsel for the Respondent did not deny that the Government had conceded this point, or say one word about it.

Now if the Commissioner did deny the Alameda permission to change its basis as stated by this Honorable Court, then that denial was in violation of the statute and amounted to the Commissioner's exceeding his authority or of abusing his discretionary powers. In either case his action is subject to judicial review according to the well settled principles of law.

The decision of this Honorable Court doubted that the Commissioner had authority to impose an obligation on either the Government or the Collector to refund taxes by permitting a change in the basis of filing returns.

We respectfully suggest that this doubt is not well founded. The statute seems to give the Commissioner such authority. If the statute does not give the Commissioner the authority to permit a change of basis for *1922,* then the election contained in section 240 (a) is not

binding upon the taxpayers for the year 1922. This is particularly true where the taxpayers filed separate returns for 1922 without knowledge of their right to file a consolidated return. Furthermore, while the result of permitting a change of basis in this case for 1922 would be a refund to appellants, the result in later years would probably be of advantage to the Government. Consolidation does not always help the taxpayer. In later years the appellants might be required to pay more tax on a consolidated return than they would on separate returns, but by reason of filing a consolidated return for 1922 they would be required to pay the excessive tax in the later years. The Commissioner, therefore, is not giving away money or rights of the Government, but is simply making a bargain or contract in behalf of the Government, for which the Government will receive a valuable consideration later.

SUMMARY.

We respectfully submit:

1. That the appellants filed their original separate returns without knowledge of their right to file a consolidated return.

2. That no binding election can be imposed on appellants where they did not have knowledge of their two inconsistent remedies.

3. That the Commissioner gave appellants, including Alameda, permission to file an amended consolidated return for all companies that were, in 1922, affiliated within the meaning of the statute.

4. That the Commissioner had the authority so to do.

5. That the statute did not permit some companies of an affiliated group to file a consolidated return, while other companies of the group filed separate returns.

6. That the Commissioner did not have authority to permit some companies of an affiliated group to file a consolidated return, and to deny the like privilege to other companies of the affiliated group.

7. That there is a presumption that public officers have performed their duties in a lawful manner.

8. That there is no presumption that public officers have acted in violation of the statute, or in excess of their authority, or that they have abused their discretionary powers.

9. That it would be an abuse of the Commissioner's discretionary power, and a violation of the specific provisions of the statute for the Commissioner to permit certain companies of an affiliated group to change their basis from the filing of separate to the filing of a consolidated return, while denying the like privilege to other companies of the affiliated group. That such abuse or excess of authority, or violation of the statue would be subject to judicial review.

10. That the Commissioner said that he excluded the Alameda from the affiliated group because he thought it was not affiliated, and not for any other reason.

11. That for the court to rule against the appellants on the ground that the Commissioner had denied the Alameda the right to change its basis from the separate to a consolidated return, would be to deny the appellants the right of judicial review of the question of affiliation.

binding upon the taxpayers for the year 1922. This is particularly true where the taxpayers filed separate returns for 1922 without knowledge of their right to file a consolidated return. Furthermore, while the result of permitting a change of basis in this case for 1922 would be a refund to appellants, the result in later years would probably be of advantage to the Government. Consolidation does not always help the taxpayer. In later years the appellants might be required to pay more tax on a consolidated return than they would on separate returns, but by reason of filing a consolidated return for 1922 they would be required to pay the excessive tax in the later years. The Commissioner, therefore, is not giving away money or rights of the Government, but is simply making a bargain or contract in behalf of the Government, for which the Government will receive a valuable consideration later.

SUMMARY.

We respectfully submit:

1. That the appellants filed their original separate returns without knowledge of their right to file a consolidated return.

2. That no binding election can be imposed on appellants where they did not have knowledge of their two inconsistent remedies.

3. That the Commissioner gave appellants, including Alameda, permission to file an amended consolidated return for all companies that were, in 1922, affiliated within the meaning of the statute.

4. That the Commissioner had the authority so to do.

5. That the statute did not permit some companies of an affiliated group to file a consolidated return, while other companies of the group filed separate returns.

6. That the Commissioner did not have authority to permit some companies of an affiliated group to file a consolidated return, and to deny the like privilege to other companies of the affiliated group.

7. That there is a presumption that public officers have performed their duties in a lawful manner.

8. That there is no presumption that public officers have acted in violation of the statute, or in excess of their authority, or that they have abused their discretionary powers.

9. That it would be an abuse of the Commissioner's discretionary power, and a violation of the specific provisions of the statute for the Commissioner to permit certain companies of an affiliated group to change their basis from the filing of separate to the filing of a consolidated return, while denying the like privilege to other companies of the affiliated group. That such abuse or excess of authority, or violation of the statue would be subject to judicial review.

10. That the Commissioner said that he excluded the Alameda from the affiliated group because he thought it was not affiliated, and not for any other reason.

11. That for the court to rule against the appellants on the ground that the Commissioner had denied the Alameda the right to change its basis from the separate to a consolidated return, would be to deny the appellants the right of judicial review of the question of affiliation.

12. That the respondent did not in his brief or in oral argument contend that the Alameda had been denied permission to change its basis from the separate to the consolidated return.

13. That there is no question of election in this case.

14. That the only questions involved are, were the companies affiliated and was the tax paid under protest, and if not paid under protest then was protest necessary?

Accordingly we respectfully submit that a rehearing should be had and the decision revised as to both law and fact, believing that a re-examination of the record after rehearing, wherein counsel will be able to assist the court better to examine and understand the record, will result in a revision and reversal of the decision herein, and that a miscarriage of justice will occur if this case is not reversed.

Respectfully submitted,

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Of Counsel.

CERTIFICATE OF COUNSEL.

State of California, County of Los Angeles—ss.

I, Melvin D. Wilson, being first duly sworn, depose and say that I am one of the attorneys for the Alameda Investment Company, Hawley Investment Company and Pacific Nash Motor Company, appellants in the above entitled cause; that I have read the foregoing petition for rehearing and in my opinion it is well founded; that the petition for rehearing is not interposed for delay.

MELVIN D. WILSON.

Subscribed and sworn to before me this 29th day of June, A. D. 1929.

(Seal)

ZELDA M. COLBY,
Notary Public.

APPENDIX.

Opinion of the Circuit Court of Appeals, Ninth Circuit.

Filed June 3, 1929. No. 5689.

Alameda Investment Co., Hawley Investment Co., Pacific Nash Motor Co., appellants, v. John P. McLaughlin, Collector of Internal Revenue for the First District of California, appellee.

Affirming District Court Decision 28 Fed. (2d) 81, Vol. 1.

Rudkin, Dietrich and Wilbur, Circuit Judges.

RUDKIN, Circuit Judge: Throughout the year 1922 the Hawley Investment Company, the Pacific Nash Motor Company and the Alameda Investment Company were corporations organized and existing under the laws of the state of California. During that period Stuart S. Hawley owned or controlled substantially all of the capital stock of the Hawley Company; the Hawley Company owned or controlled substantially all of the capital stock of the Motor Company, and Hawley and the Hawley Company owned or controlled 73½ per cent of the capital stock of the Alameda Company. An additional 25 per cent of the capital stock of the Alameda Company was owned by members of the Meek family, related to Hawley by marriage. During the year in question the Hawley Company and the Motor Company suffered net losses aggregating in excess of $250,000 while the Alameda Company earned a net income in excess of $120,000. In March of 1923 the three corporations made separate income tax returns for the year 1922, under the Revenue Act of 1921, show-

ing losses and gain as above indicated, and upon the return of the Alameda Company there was paid in taxes during the year 1923 the sum of $15,087.27. On June 11, 1924, the three corporations applied to the Commissioner of Internal Revenue for permission to file a consolidated return of income for the year 1922, pursuant to section 240 of the Revenue Act of 1921 (42 Stat. 260), which provides:

"(a) That corporations which are affiliated within the meaning of this section may, for any taxable year beginning on or after January 1, 1922, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner."

The Commissioner permitted the Hawley Company and the Motor Company to file a consolidated return, but denied the like privilege to the Alameda Company on the ground that it was not affiliated with the other two corporations within the meaning of the law. The present action was thereafter instituted against the Collector of Internal Revenue to recover the taxes paid by the Alameda Company on its separate return, and from a judgment in favor of the defendant the plaintiffs have appealed.

It will be observed that under the Revenue Act of 1921 corporations which are affiliated within the meaning of the law may make separate returns or at their option a

consolidated return, under regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and the basis upon which the return is made for the year 1922 controls in *succeeding* years unless permission to change the basis is granted by the Commissioner. The separate and consolidated returns differ widely in form, with different results to both the taxpayers and the government, and it would seem *obvious* that when the taxpayers have once made their election, filed their returns, separate or consolidated, and paid their taxes, the election is binding on all parties concerned. We have not lost sight of the fact that the complainant alleged that the separate returns were made through inadvertence and without knowledge that the taxpayers were entitled to make a consolidated return; but the allegation was denied by answer and no proof whatever was offered in its support. Here the Alameda Company made its separate return and paid its taxes. The return was regular in form, the taxes were due the government and were lawfully collected, and the *right or power* of the Commissioner of Internal Revenue to thereafter impose an obligation on either the government or the collector to refund the taxes by permitting a complete change in the return would seem to admit of grave doubt, to say the least. But if it be conceded that the Commissioner had such power in any case, he was under no legal obligation to exercise it in behalf of the appellants and his refusal so to do *is not subject to review in the courts.* Regardless, therefore, of whether the appellants might have made a consolidated return in the first instance, the judgment must be affirmed. It is so ordered.